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MONTANA STATE FUND
FINANCE AND AUDIT COMMITTEE
September 8, 2022

The Montana State Fund (MSF) Finance and Audit Committee meeting was held September 8, 2022 in MSF's Board Room at 855 Front Street, Helena, Montana 59601 and via Zoom.

<u>Directors Attending</u>

Karen Fagg, Billings
John Maxness, Helena

<u>Board Members Attending</u>

Richard Miltenberger, Helena
Michael Marsh, Billings
Jan VanRiper, Missoula

<u>MSF Staff Attending</u>

Holly O'Dell, President/CEO
Rene Martello, Controller
Kevin Braun, General Counsel
Darcie Dunlap, Internal Actuary
Patti Grosfield, Internal Auditor
Mark Burzynski, Corporate Support VP
Kathy Gowen, Corporate Paralegal

<u>Others Attending</u>

Russell Greig, WTW – Via Zoom
Alex Turrell, WTW - Via Zoom
Sonia Powell, OBPP
Peter Strauss, MSIA

I. Meeting Preliminaries

A. Call to Order

The meeting was called to order at 1:02 p.m.

B. Approval of May 23, 2022 Finance and Audit Committee Meeting Minutes

The Committee took action to approve the minutes as presented; Mr. Maxness made the motion, Chair Fagg seconded, the motion passed unanimously.

It was noted that Committee Member Jack Owens was unable to attend this meeting and that Board Chair Richard Miltenberger was in attendance.

III. Internal Auditor Report - Patti Grosfield, Internal Auditor (Board Member Michael Marsh had not yet joined the meeting so the Committee advanced to the next agenda item.

External Audits:

- Eide Bailly will begin field work for the Calendar Year 2022 Statutory Financial Statements Audit in December 2022 remotely. Field work will be completed in February 2023 and the report will be completed by April 2023.

- The Legislative Audit Division (LAD) is exploring options to contract for the completion of the Calendar Year 2022 GASB (governmental) Financial Compliance Audit by Eide Bailly, LLC.

  The use of Eide Bailly to complete this contract may only be for a one-year period because the existing contract with MSF expires September 30, 2023.

- The Calendar Year 2021 GASB Financial Statements Audit was completed by LAD but has not yet been released to the public. The report will be presented to the Legislative Audit Committee (LAC) on October 4, 2022, and MSF staff will provide a response and answer questions at the Committee meeting. Board members will receive a "Blue Cover" audit report.

- LAD is performing an Information Systems Audit on the Policy Center and Billing Center which is a transactional processing audit. This audit is in the planning phase and LAD is gathering preliminary documentation from MSF's subject matter experts. The entrance conference will be on September 26, 2022, and LAD is targeting completion by the end of 2022. This audit will include a separate "Blue Cover" report.

Internal Audits:

- Continued Internal Control testing and Regulatory Compliance Reviews are ongoing. The Market Conduct Exam and the Financial Conduct Exam are in process and staff has been responsive to information requests.

- System access reviews are differentiated between preventive controls (review before access is granted) and detective controls (after the fact for review of who accessed and their actions.)

- The PBRI Process and Payments audit, which was requested by the MSF Board of Directors, was recently begun. The audit will review the timeline from pre-project (travel and RFP) through December 31, 2022, and beyond. The overall scope will review how much MSF has paid, to whom, and do the payments align with the contractual obligations that the Board authorized in project discussions, and the ultimate deliverables. The target is for the audit report to be presented at the December Finance and Audit Committee meeting.

  Committee Members requested a thorough and robust report to better understand the processes, timeline and overall expenses, as well as lessons learned. They indicated that a look back at the December Finance and Audit Committee Meeting would suffice for the Committee and in the future a report to the Board on strategic planning for future projects would be appreciated.

  Staff explained there are on-going expenses related to the number of years the project lasted and the planning presentation will map out the expenses that have been committed to and share out the lifecycle of a typical core system decision-making process. The retrospective audit will be delivered in December and the strategic piece will tie well with the multi-year expansion of the Annual Business Planning process that has been implemented.
  President O'Dell stated that based upon Board member requests, MSF staff will include the accuracy of the payments and settlement payments in the retrospective audit scope presented to the Finance and Audit Committee and will prepare a verbal report out regarding the negotiations and resolutions for an Executive Session at the full Board meeting.

- A Dividend audit will be completed should a dividend be declared by the Board. The Committee was reminded that the Multiple Public Disclosure requirement will be upcoming and due on December 15, 2022 to the Commissioner of Political Practices. MSF will also be issuing the Code of Conduct and Data Confidentiality forms.

Committee members requested the forms be made available for completion at the December Board meeting for ease of completion on-site. Staff offered to work on the early completion of the forms to accommodate that request.

II. Kids Chance Proposal – Michael Marsh

Chair Fagg noted that the additional information regarding the Kids Chance proposal requested by the Committee at the last meeting had been provided.

Mr. Marsh provided background information on the development of the Kids Chance program and the Kids Chance Board in Montana. He reported that he brought this proposal to the Committee for consideration and approval based on MSF's market share and that it is a critical component for workers' compensation in Montana. He added that he felt that we, at MSF, owe a bit of a duty of giveback to the people of Montana even if the employer isn't insured with MSF.

He noted that MSF has contributed approximately $50,000 to date. He proposed that the yearly evaluation process be eliminated and to fund Kids Chance for a longer period of time by MSF contributing $1 million to a Kids Chance endowment account. He indicated that if the endowment could be funded at over a million dollars, it would go a long way toward providing scholarships into the future. Other insurers are participating, but not to the level the Kids Chance Board believes they should be. MSF's $1 million contribution would send a message to the industry that it is time to participate in earnest and this contribution would be used by the Kids Chance Board as a lever in their fundraising efforts. He requested the Committee recommend the Board adopt this proposal.

Chair Fagg asked if Kids Chance of America will continue their generous donations into the future. Mr. Marsh reported that they donate $7,500 to each state for administration support and that will continue throughout the life of the program.

Committee members and Board members expressed support for the Kids Chance program as well as the similar MSF scholarship program and expressed dismay that there was not more private participation in funding them. Donating $1 million seemed excessive, particularly with concerns regarding the current inflationary economy and the status of MSF's reserves, equity and declining investment income. MSF stepping forward and matching to a certain level from private industry contributions could incentivize private industry to step forward with this very worthy program.

Board Chair Miltenberger challenged the Board members to contribute their Board reimbursements to Kids Chance and provide staff with the information needed to personally contribute through the United Way program.

The Committee took action to recommend to the full Board approval of a matching maximum donation to Kids Chance of Montana in an amount of up to $150,000 over the course of five years beginning in 2023, capped at $30,000 per year of matching funds, that Kids Chance of Montana receives from sources other than Montana State Fund. Chair Fagg made the motion, Mr. Maxness seconded the motion, the motion passed unanimously.

IV. Financials and Budget – Rene Martello, Controller

A. Calendar Year 2022 Second Quarter Financial Report

As of June 30, 2022, total admitted assets decreased to $66.1 million as compared to the end of 2021. Unrealized losses in equities securities of $42.8 million is the primary driver for that reduction; however, recently the decrease reflected is closer to $18 million. Other admitted assets decreased $22.9 million which reflects an expected decrease in accounts receivable as premium is billed and paid. Policyholder equity as of June 30, 2022 decreased to $622.1 million or $24.3 million less than the end of 2021.

Premiums are expected to come in higher than planned despite the three percent rate reduction due to higher payroll growth. Losses are expected to be $4.2 million more than planned, expenses are aligned to plan and second quarter net income, before dividends, is $11 million which is $23.9 million below plan. Ms. Martello presented the major variances, comparing this year to last year and explained the varying reasons for the differences. Overall policyholder equity is projected to be $623 million at the end of 2022 compared to $622.1million in 2021 as 2022 has seen $7.5 million of realized losses.

B. *Calendar Year 2022 Second Quarter Budget*

The 2022 projection is based on the January 1, 2022 to June 30, 2022 actual expenditures, trends of current and prior years and additional information as available from staff. Overall, MSF is projected to be $936,000 over budget for the year because Operational Expenditures such as personal services, operating expenses, transfers and capital outlay were trending unfavorably at $1.1 million or 1.7% over budget. Claim benefit payments were projected to be trending close to plan at $172,000 or 0.2% under budget.

Overall, benefit payments are projected to be slightly under budget. Total indemnity is projected to be over $1.3 million or 3.3% over and total medical projected to be $1.5 million or 2.1% under. The net under budget variance is primarily driven by medical settlements and is projected to be $18.9 million on a projected budget of $21.6 million, $2.7 million or 12.7% under. The indemnity budget is $39.4 million and was projected to be $40.7 million, $1.3 million or 3.3% over.

The medical budget is $72.3 million and was projected to be $70.8 million - $1.5 million or 2.1% under. This projection includes a $5.1 million settlement in the first half of 2022 and $2.7 million for the remainder of 2022. The 2022 budget of $111.7 million is an 8% increase from the 2021 Actuals of $103.5 million.

Operations expenditures are expected to be over budget by $1.1 million or 1.7 percent over the projection of $66.7 million. This is driven primarily by the higher-than-expected agent commissions, capital expenditures over budget due to the fire panel upgrade and the allocated loss adjustment expenses under budget in most categories.

V. Policyholder Equity and Dividend – Holly O’Dell, President/CEO

A. *Analysis of Policyholder Equity Adequacy and Policyholder Dividend Program – Russell Greig, Senior Director, WTW*

MSF requested that WTW’s analysis of MSF’s policyholder equity adequacy included the level of equity MSF needs to support its long-term viability and stability for Montana employers and MSF’s long-term business plans and how those equity levels are affected by changes in the business environment. Does this year’s financial situation support a dividend? The analysis found this was the 24th consecutive year the MSF Board has considered these questions and showed that premium and loss reserves have stabilized while policyholder equity has increased over recent years.

Mr. Greig walked the Committee through the analysis process and concluded that MSF has the financial performance and financial strength to declare a small-to-medium dividend this year.

Clarification on what was considered a large dividend was requested and Mr. Greig said anything higher than $50 to $60 million.

B. *Policyholder Equity Level Determination and Discussion – Management Recommendations – Holly O'Dell, President/CEO*

Staff adjusted their recommendations to provided information to the Board on their decisions whether to issue a dividend, how much would be recommended and how to distribute the dividend amongst policyholders.

Dividend consideration should be based on two factors - the long-term financial stability and strength of MSF and the impact to Montana's workers' compensation market. MSF's objective is to attract and maintain policyholders which allows MSF to contribute to mission by having the policyholder base to share the work done and gain the claims management safety services that MSF offers. Management's recommendation included considerations of the current level of equity, MSF's specific accident-year financial results and financial performance back to 2020, as well as trends and the currently unique market conditions.

Management supports a dividend philosophy of looking at the approach over multiple years and taking a graduated, slow and stable approach for this year. MSF, based on sufficient security and equity, is well positioned to declare a dividend and President O'Dell noted that staff had modeled for the Committee's consideration amounts of $20 million, $25 million or $30 million. She recommended the Committee consider a $30 million dividend to assure MSF can still contribute to growing policyholder equity over time to achieve the Board's target of a 1.0 reserve-to-equity ratio.

Committee members commented that they too could support recommending a $30 million dividend to the Board.

C. *Dividend Program Rules*

President O'Dell explained that the dividend distribution model used in the past shares the amount declared by the Board through a loss sensitive approach. Eligible policyholders received a share of the dividend based on their individual losses, meaning those with the highest losses did not receive a dividend at all. This structure saw about 95 percent of policyholders receiving a dividend. An alternate approach also used by State Funds and other carriers is a non-loss sensitive model. This model is a per capita approach where the total dividend amount declared is divided by the premium that each policyholder paid and each policyholder receives back a percentage. With this model almost 100 percent of policyholders are eligible for a dividend. It is not based on losses, it is based on their tenure as an MSF policyholder for long enough in a given year.

Pros for the loss-sensitive dividend model include the fairness of rewarding policyholders who contributed to loss ratio results in a way that aligns with their premium level. This model is very precise and has the potential of motivating policyholders to continue to deliver strong results. A non-loss sensitive program addresses some of the cons of loss-sensitive programs - they are very complicated (MSF's table is difficult to understand) and it takes a long time to view the results of the year to identify some sense of how each policyholder did and issue the dividend. Should the Board move to a non-loss-sensitive dividend process, MSF could move up the timing significantly and pay the dividend closer to the policy year. The loss-sensitive dividend process is difficult for agents and MSF staff to explain and not everyone receives a dividend. Most importantly the loss-sensitive model is driving the opposite safety behavior that MSF wants. Over recent years as the dividend increased a much greater percentage of policyholders received a dividend and were being told it was because of their increased safety behaviors; however, a large portion of those were not taking active safety culture behaviors and were lucky instead.

This is a good year to consider the non-loss-sensitive approach because safety results are not that strong this year and MSF is using equity to smooth the experience for the market. She noted that for this year, she recommended moving to a non-loss-sensitive dividend process. In the future this recommendation could be different based on a better understanding of how to influence stronger safety cultures with our policyholders.

An additional factor in this recommendation is that the smallest of policyholders' customer experience could be enhanced by this approach. Regardless of the premium paid, as long as the policyholder paid $100 in premium, they would get at least $100 back plus the percentage of premium they would be entitled to - no small checks and no credits.

President O'Dell said she recommended adopting a non-loss-sensitive across-the-board per capita dividend approach with a $100 minimum per policyholder.

Committee members and Board members indicated they liked the simplicity of this approach.

President O'Dell noted that staff recommends the same timing for 2022 which would require the Board to vote on adopting the non-loss-sensitive approach before voting for a dividend. Next year and the year after, "catch up" solutions could be offered that review different dividend year periods

Staff provided an overview of the non-loss sensitive dividend program also called a percent-of-premium program based on a hypothetical declaration of $30 million. The minimum dividend amount would be $100, the percent of premium (flat rate) would be 19.94 percent and the distributed dividend would be $29,995,858 with 23,137 policyholders that would receive a dividend. Eligibility factors include six months of continuous coverage in the dividend year and reconciled premium. Each policyholder will receive a bit less with this process due partially to the fact a smaller dividend is recommended for this year and more policyholders will qualify to receive a dividend. Staff recommended that all dividends be issued in check form rather than as credits except for those policyholders with an outstanding obligation to MSF.

The Committee took action to recommend to the full Board approval of the revised dividend program rules. Mr. Maxness made the motion, Chair Fagg seconded the motion and the motion passed unanimously.

D. Declaration of Dividend
The Committee took action to recommend to the full Board, based on the unreserved Policyholder Equity of $646,425,178 as of December 31, 2021, to declare a percent of premium dividend for dividend year 2020 policies of approximately $30 million dollars, with a minimum dividend amount of $100.00 payable to qualified policyholders not to exceed 2% above or more than 2% below the declared dividend, exclusive of any uncashed warrants.

Mr. Maxness made the motion, Chair Fagg seconded the motion. The Chair called for public input; there was none. The motion passed unanimously.

The Committee took action to recommend to the full Board approval of the recommendations of staff to:

-Approve the dividend distribution factor for the percent of premium dividend; and

-Distribute the dividend to all qualifying policyholders with new or renewal dates within the dividend year of July 1, 2019 through June 30, 2020, and who had at least six months continuous coverage during their policy period. Mr. Maxness made the motion, Chair Fagg seconded the motion. The Chair called for public input; there was none. The motion passed unanimously.

VI. Old Fund – Status and Reserve Report

A. Old Fund Overview (Fiscal Year 2022 Funding Status – Rene Martello, Controller

As of June 30, 2022, Old Fund expenditures were $6 million which was $1.4 million or 19% under the funding estimate of $7.4 million. Claim benefit payments were $5.3 million which was $1.3 million under the funding estimate. Medical expenses were under by $730,000 and indemnity was under by $574,000. A large settlement was in progress close to fiscal year-end 2022 but did not settle until August and will be in seen Fiscal Year 2023 results.

Old Fund operating expenses include the administrative cost, legal cost allocation and State warrant writing, the Department of Labor and Industry (DOLI) Assessment, and allocated loss adjustment expense (ALAE). Operating Expenses were $732,000 which was $81,000 or 10% under the funding estimate. At the close of fiscal year 2022, there were 403 open claims, as of August 31, 2022 there are 399 open claims in the Old Fund.

B. Old Fund Fiscal Year 2022 Reserve Report – Alex Turrell, Director, WTW

The analysis for the Old Fund unpaid claims projection was completed by WTW to estimate the amount of unpaid future claims benefits as of June 30, 2022 and include a provision for claim administration expenses and the DOLI assessment. WTW's total estimated undiscounted future benefit payments are $36.1 million, $4.3 million for unpaid claims administration, and $1.1 million for the DOLI assessment for a total claim-related unpaid estimate of $41.5 million.

C. Adoption of Old Fund Fiscal Year 2022 Unpaid Loss and Loss Adjustment Expense Reserve Estimate

Staff requested the Committee recommend the approval of the Old Fund reserves.

The Committee took action to recommend the full Board adopt for the Old Fund, based on the actuary's best estimate of unpaid losses and loss adjustment expenses as of June 30, 2022, the amount of $41,477,506, undiscounted. Mr. Maxness made the motion, Chair Fagg seconded the motion. Chair Fagg called for public input; there was none. The motion passed unanimously.

VII. Whistleblower Protections – Kevin Braun, General Counsel

A. Third Party Reporting Service

Mr. Braun presented an overview of the revised quote for a hotline service that the Board requested be considered for employees to be able to report conduct that is illegal, dishonest, unethical or otherwise improper. This service reports directly to the Board and respects employees' -privacy and security in reporting.

The Committee took action to recommend to the full Board approval of the two-year proposal from Lighthouse by Syntio anonymous hotline reporting service for use by Montana State Fund employees to report illegal, unethical or policy violations. Mr. Maxness made the motion and Chair Fagg seconded the motion. Chair Fagg called for public input; there was none. The motion passed unanimously.

VIII . Old Business/New Business

Chair Fagg called for old or new business.

IX. Public Comment

Chair Fagg called for public comment. There was none.

The meeting adjourned at 4:10 p.m. The next scheduled Finance and Audit Committee meeting will be held on Thursday, December 8, 2022 at Montana State Fund, 855 Front Street, Helena, Montana in the first floor Board Room.

Respectfully submitted,

Verna Boucher
Special Assistant to the President/CEO